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TREASURY FOR INTERNATIONAL AFFAIRS LARRY NORTON

SIPDIS

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SUBJECT: CROATIAN FDI SUFFERS WITHOUT LARGE PRIVATIZATIONS

¶1. Summary. The Croatian National Bank (HNS) reported that foreign direct investment (FDI) declined 50% through the first six months of 2009 compared to the same period in 2008. Senior economists from private banks blame the financial crisis for the drop, but also point to high labor costs, red tape, and land ownership problems that hinder CroatiaQs attractiveness for investors. Croatia has reported relatively high levels of foreign investment since 1993 thanks in part to continuing privatizations of state owned industries. With few remaining large assets planned for sale, Croatia will be forced to address fundamental problems with the investment climate in order to attract new investment. End summary.

¶2. Croatian National Bank (HNB) Senior Advisor Alan Skudar reported on September 17 that CroatiaQs Foreign Direct Investment (FDI) amounted to 900 million euros for the first six months of 2009, a decline of 50% compared to the same period in 2008. Skudar said that the HNB expected a similar if not greater decline in the second half of 2009. He noted that the financial services sector receives about 41% of total foreign investments in the country, whereas the manufacturing industry claims only a 27% share of investment.

¶4. Senior financial analysts from Croatian commercial banks commented in the press that the current economic crisis is the main reason for the decline in CroatiaQs FDI. However, Italian UniCreditQs chief economist for Croatia told us that with privatizations of major state owned enterprises almost complete, Croatia has lost its major source of FDI. The last significant state owned industry planned for sale is the shipbuilding industry, with six yards currently up for tender. However, the government will realize little if any income from the sale as the bid price for most of the yards is one kuna, with bidders submitting investment and debt repayment plans for consideration by the privatization fund.

¶5. Notwithstanding the drop in FDI this year, Croatia has recently been the leader in FDI for southeastern Europe, based on 2008 figures: Croatia ($3.3 billion), Serbia ($2.9 billion), Bosnia and Herzegovina ($1 billion), Albania and Montenegro ($950 million) and Macedonia ($598 million). HNB reported that CroatiaQs banking and telecommunication sectors have lately been the strongest performers as evidenced by the fact that foreign investors have had sufficient earnings in these sectors to make withdrawals to cover losses in other areas.

¶6. Comment. The low FDI figures for 2009 reveal a disturbing but not surprising trend. Buoyed for years by the privatization of large, relatively well-managed companies with competitive products such as Pliva and Hrvatski Telekom, Croatia enjoyed FDI revenue much higher than its economic and investment climate might normally dictate. Croatia now must attract investment on its own economic merits. The low share of foreign investment going into manufacturing, and the even lower share that can be categorized as green field investment, testify to CroatiaQs weaknesses in this regard.